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421930—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

Nos. 659 and 660

MOLONEY ELECTRIC COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 15–29) is reported in 42 B. T. A. 78. The opinion of the Circuit Court of Appeals (R. 105–113) is reported in 120 F. (2d) 617.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 9, 1941. (R. 113–114.) A petition for rehearing was filed June 20, 1941 (R. 115–117) and denied June 27, 1941 (R. 119). The petition for a writ of certiorari was filed Sep-

tember 27, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. A trust agreement contained a provision requiring the taxpayer corporation to pay to the trustee for sinking fund purposes on a specified date each year a sum equal to 2% of the largest amount of debenture bonds at any time outstanding. The question in No. 659 is whether the provision "expressly deals with the disposition of earnings and profits of the taxable year" within the meaning of Section 26 (c) (2) of the Revenue Act of 1936.

2. The trust agreement also contained a provision requiring the taxpayer to pay to the trustee for sinking fund purposes 20% of its net earnings for the preceding year in excess of a specified sum, the amount due to be determined and forthwith set aside at the close of each calendar year and no later than April 1 and to be paid thereafter on June 1. A question in No. 660 is whether this provision required the amount to be paid or set aside "within the taxable year" as specified in Section 26 (c) (2). A further question is whether there was evidence that the taxpayer in retiring the bonds which were outstanding in the taxable year paid any portion of the amount because required to do so under the agreement.

STATUTE AND REGULATIONS INVOLVED

Section 26 of the Revenue Act of 1936 (49 Stat. 1648) provides:

> In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—
>
> * * * * *
>
> (c) *Contracts Restricting Payment of Dividends.*—
>
> * * * * *
>
> (2) *Disposition of Profits of Taxable Year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. * * *
>
> * * * * *

Other provisions of the Act are set forth in the Appendix, *infra,* pp. 11–13, together with the pertinent Treasury Regulations.

STATEMENT

On June 1, 1928, the taxpayer, Moloney Electric Company, issued bonds due June 1, 1943, in the

aggregate principal amount of $1,500,000 (R. 20). The trust indenture (R. 65–95) entered into in connection with the issuance of these bonds required the taxpayer to pay to the trustees for sinking fund purposes on the first day of June, 1930, and on the first day of each succeeding June "a sum equal to 2% of the largest amount of debenture bonds at any time outstanding". The taxpayer was also required for sinking fund purposes on the first day of June, 1930, and on the first day of each succeeding June to pay to the trustee 20% of the net earnings of the company for the next preceding year in excess of $320,000 (R. 21). The following are the pertinent provisions of the trust agreement (R. 68–69, 71):

ARTICLE III.

> SECTION 1. The Company covenants that as a sinking fund for the retirement of debenture bonds issued hereunder it will pay to the Trustee on the first day of June, 1930, and the first day of each succeeding June thereafter, so long as any of the debenture bonds hereby authorized are outstanding, a sum equal to 2% of the largest amount of debenture bonds at any time outstanding, and will also pay on said date to the said Trustee 20% of the net earnings, for the next preceding year, as hereinafter defined, of the Company in excess of Three Hundred Twenty Thousand Dollars ($320,000). The determination of the sum to be paid to the sinking fund from

the net earnings shall be made from an audit to be made at the close of each calendar year by a firm of certified public accountants acceptable to the Trustee, and when said net earnings are so determined from said audit, which, in no event, shall be later than the first day of each April, said amount shall forthwith be set aside in a separate fund by the Company and shall be paid to the Trustee as herein provided on the first day of June of each year, beginning in the year 1930.

* * * * *

SECTION 3. The Company may, at its option, at any time redeem all or any part of the debenture bonds then outstanding hereunder. Such redemption shall be upon thirty (30) days' published notice as hereinabove provided, and at the price of One Hundred and Three Dollars ($103.00), and accrued interest to date of redemption, for each debenture bond.

* * * * *

Bonds in the aggregate principal amount of $690,500, were outstanding at the beginning of the taxable year 1936. They were all retired during that year. (R. 22.)

In the petition before the Board of Tax Appeals for a redetermination of the Commissioner's proposed deficiency assessment for the year 1936, the taxpayer claimed that in computing the surtax on undistributed profits imposed by the Revenue Act of 1936 it was entitled to a credit under

Section 26 (c) (2) of $13,810 (R. 7). This amount is 2 per cent of $690,500, which was the largest amount of the taxpayer's bonds at any time outstanding during the year 1936. This claim was sustained by the Board (R. 29) and is the issue with respect to which the Commissioner sought review in the court below (R. 35–40).

In its petition for redetermination before the Board, the taxpayer claimed a further credit under Section 26 (c) (2) of $31,526.66 (R. 7). This amount is 20 per cent of $157,633.31, the alleged net earnings for the year 1936 in excess of $320,000. This claim was overruled by the Board (R. 27) and is the issue with respect to which the taxpayer sought review (R. 43–48).

The court below sustained the Commissioner in both cases, and accordingly reversed in part and affirmed in part the decision of the Board of Tax Appeals (R. 113–114).

ARGUMENT

The decision of the court below is correct in both cases and there is no conflict or other reason for review.[1] Contrary to petitioner's assertion (Pet. 6), the cases do not present any important

[1] No conflict is alleged by petitioner. The possibility that the Circuit Court of Appeals for the Sixth Circuit, in one or more of the four cases cited (Pet. 6) by petitioner as now pending before it, might render a decision in conflict with those of the court below constitutes no ground for granting or postponing disposition of the petition herein.

issue of Federal law which this Court should determine. They merely involve claims to credits in the computation of the surtax imposed by the Revenue Act of 1936 upon undistributed corporate profits, and their outcome turns, not on any new or far-reaching principle of law, but on the particular facts.

1. The claim involved in No. 659 is that to a credit of $13,810, representing 2% of the largest amount of debenture bonds outstanding in 1936. The court below held (R. 109–111) this claim invalid for the reason that no portion of the payment for the retirement of the bonds was required by a contract provision which, as specified in Section 26 (c) (2), "expressly deals with the disposition of earnings and profits * * *." This holding was plainly correct. The trust agreement (Art. III, Sec. 1) obligated petitioner to pay the 2% amount irrespective of earnings and profits. Even if the provision imposing the obligation could be said to have been intended to deal with the disposition of earnings and profits, as was the Board's view (R. 28), it did not do so "expressly", and Section 26 (c) (2), like other credit provisions, is to be construed strictly. See *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, 47.

Petitioner concedes (Pet. 2) that the agreement required it to pay the 2% amount irrespective of earnings and profits. But it apparently contends (Pet. 6) that every payment for which a taxpayer would be entitled to a credit under Section 26

(c) (2) must necessarily be required irrespective of earnings and profits, since otherwise the payment would not be for the discharge of a "debt". However, even if it were true that an obligation, to be a "debt", must be payable in any event, petitioner's cause would not be advanced, for, as already said, the statute requires that the contract contain a provision expressly dealing with the disposition of earnings and profits.

2. The credit claimed in No. 660 is for $31,526.66, representing 20% of petitioner's net earnings in 1936 in excess of $320,000. The Board (R. 23–27) and the court below (R. 111–113) sustained the disallowance of this credit on the ground that the trust agreement concededly (R. 25) did not require any of the amount to be paid or set aside "within the taxable year", as specified in Section 26 (c) (2), and on the further ground that, in any event, there was no evidence that petitioner in liquidating its bonded indebtedness had paid any of the amount because of the contract requirement to pay 20% (Art. III, Sec. 1), rather than simply because it chose to exercise its option under the agreement (Art. III, Sec. 3) to redeem the bonds upon 30 days notice. Each of these grounds is well taken and either would alone suffice to defeat the claim.

Petitioner does not mention or make any argument with respect to the second of the foregoing grounds and its contention as to the first is without merit. It states (Pet. 2, 5, 6) that the court

below overlooked the second sentence of Section 26 (c) (2), the implication being, as urged in its petition for rehearing in the court below (R. 116), that the provisions of that sentence, unless nugatory, have the effect of modifying the phrase "within the taxable year", as used in the first sentence, to mean "within the accounting year". Clearly, however, the provisions of the second sentence have no such effect; they merely make the credit available in cases where the contract requires the payment or setting aside within the taxable year of "an amount equal to a percentage of earnings and profits", as well as in the cases covered by the first sentence where the credit is allowed for "the portion of the earnings and profits" required to be paid or set aside within the taxable year.

CONCLUSION

For the reasons stated, the petition for writs of certiorari should be denied.

Respectfully submitted,

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